

**Testimony of Ambassador Charlene Barshefsky
U.S. Trade Representative**

**Renewal of Normal Trade Relations with China
Senate Committee on Finance**

July 9, 1998

Thank you, Mr. Chairman, for calling this hearing and inviting the Administration's comments on normal trade relations with China.

ENGAGEMENT WITH CHINA

Normal trade relations are the standard tariff rates, now averaging less than 4%, which we accord virtually all our trade partners. As the Finance Committee has noted, the term now used to describe normal trade relations -- Most Favored Nation status -- is a misnomer, since virtually all our trade partners now enjoy it.

Under the Jackson-Vanik Amendment, however, certain economies including China are ineligible for these rates unless the President grants an annual waiver. On June 3rd, 1998, President Clinton sent to Congress this waiver, extending normal trade relations to China for a year.

This decision reflects the President's broad strategy of engagement with China on the full range of issues our China policy must address. As the world's most populous country, and for the past decade its fastest-growing major economy, China will play a crucial role in the major international issues our country will face in the decades to come. In his address at the National Geographic Society last month, and during his State Visit to China, the President noted that these issues range from maintaining the peace in Korea; a united international approach to the nuclear tests in South Asia; controls on proliferation of nuclear, chemical and biological weapons and ballistic missiles; international crime and drug trafficking; pollution and climate change; human rights and religious freedom; a solution to the Asian financial crisis; and a more open trade relationship between our countries.

The United States' interest in these issues is best served by a secure, stable and open China. And the President believes, as have all Presidents since the 1970s, that we can best guarantee the evolution of a secure, stable and open China through comprehensive engagement. Engagement does not mean endorsement of Chinese policies. It is, instead, the best way to further our interests across this broad range of issues.

NORMAL TRADE RELATIONS

Normal trade relations are a fundamental part of engagement. Every President since the initial grant of normal trade relations in 1980 has renewed normal trade relations each year. And

the Clinton Administration is committed to working with Congress to make sure they are extended once again this year.

The renewal of normal trade relations is in our economic interest, since trade with China supports jobs and farm income in America. While significant trade barriers continue to hamper our exports to China, since we opened normal trade relations, our exports of goods to China have grown from an insignificant level to \$12.8 billion. China has become our sixth largest agricultural market. And together, exports to China and Hong Kong now support over 400,000 American jobs.

Normal trade relations, by helping to integrate China into the Pacific trading world, are also in our broader strategic interest. One example is China's response to the Asian financial crisis. Trade with the United States has helped to spur investment in China from Hong Kong, Taiwanese and Southeast Asian companies. This has given China a stake in economic stability throughout the region. Thus, China, for reasons of its own national interest, contributed to the IMF recovery packages for Thailand and Indonesia; and still more important, has resisted pressure to devalue its currency. President Jiang Zemin repeated China's commitment not to devalue during his summit meeting with President Clinton.

And normal trade relations serve American values as well as interests. By enabling us to trade with China, normal trade relations promotes human contacts, exchange of ideas, and the rule of law. Computers, fax machines, television satellites, cell phones, books, music and movies are more than goods and services crossing oceans and borders -- they are the exchange of ideas. They already allow Chinese university students to debate US-China relations and economic reform on university bulletin boards, contributing to grass-roots inquiry and debate. And trade agreements themselves are expressions of broader international values which we seek to promote worldwide: transparency, peaceful settlement of disputes and limits on the arbitrary power of the state.

EFFECTS OF REVOKING NORMAL TRADE RELATIONS: TRADE

By contrast, failing to renew normal trade relations would severely damage American interests and lessen our ability to promote basic values.

With respect to jobs and growth in America, the effects of ending normal trade relations would be severe. It would, in fact, amount to the severing of our trade relationship and our strategic political relationship. Technically, revoking MFN would raise tariffs on Chinese products from less than 4% today to a trade-weighted average of 44%. This would make American consumers pay approximately \$590 million more each year for goods such as shoes, clothing and small appliances. Manufacturers would see the cost of goods made with Chinese components rise sharply, reducing the competitiveness of our goods in domestic and international markets.

China would likely retaliate against US exports by increasing tariffs and other measures, endangering direct U.S. goods exports valued at \$12.8 billion last year, and services exports valued at \$3 billion in 1996 (the last year for which we have figures). This would threaten the jobs of manufacturing workers, the income of farmers, the employment of young workers in retailing, software engineers and workers in every other walk of life. Their jobs and the export opportunities of their employers would go to Japan, Europe and other competitors.

Ending normal trade relations would also derail our bilateral and multilateral negotiations. China could, for example, reduce or end its efforts to enforce our intellectual property agreements, reversing our successful effort to build an infrastructure of laws and law enforcement in this crucial field. Negotiation on WTO accession would stop, creating uncertainty about the future evolution of China's markets. And much of the human contact between Americans and Chinese would end, limiting the exchange of ideas and values across the Pacific.

EFFECTS OF REVOKING NORMAL TRADE RELATIONS: BROADER ISSUES

The effects of ending normal trade relations with China would, however, go well beyond trade. Let me mention three areas of strategic concern to the United States.

First, ending normal trade relations would likely endanger cooperation with China in areas outside trade. It would call into question our recently developed good working relationship against drugs and international crime. It would make progress on human rights, as symbolized by the recent release of several well-known Chinese dissidents, very difficult or even impossible. And it could threaten cooperation in national security questions such as the four-party talks on Korea and missile sales in the Middle East.

Second, ending normal trade relations would badly damage Hong Kong. Hong Kong's economy is based on trade and services. As much as three quarters of US-China trade goes through its port. Hong Kong authorities estimate that ending normal trade relations would slash its trade volume by up to \$34 billion, and income by \$4.5 billion.

This would cause immediate suffering and long-term uncertainty among Hong Kong people about the territory's economic future, and lessen international business confidence in Hong Kong as a trade and financial center. And it would come at the worst possible time -- when Hong Kong's growth has slowed and its unemployment rate is at a fifteen-year high, and just after it conducted its first election as the Hong Kong Special Administrative Region, with the highest voter turnout ever in any Hong Kong election. That is why all leading Hong Kong figures, including Chief Executive C.H. Tung, Civil Service Chief Secretary Anson Chan, and Democratic Party leader Martin Lee, support normal trade relations.

Third, ending normal trade relations would deal a severe blow to our larger efforts to solve the Asian financial crisis. This crisis already affects our own economy, as we can see through a drop in exports to the Asian region and layoffs at companies which export to Asia. The

stability of the Chinese economy during this difficult period, and the efforts of both the central Chinese government and the government of Hong Kong to avoid devaluing their currencies, have helped prevent further deterioration. A disruption of the magnitude of revoking normal trade relations would introduce new financial and economic instability to Asia, with unpredictable but likely very negative effects in the region and on the American economy.

Altogether, then, the vote on trade with China is not on whether to endorse Chinese policies, but on whether to protect fundamental U.S. interests. The Administration thus strongly supports renewal of normal trade relations.

US-CHINA TRADE RELATIONS

As we look to the future, normal trade relations allows us to conduct a strategic trade policy aimed at ensuring that Americans can achieve the full potential benefits of trade with China.

These benefits are substantial. China's economy is already among the largest in the world, and such leading American industries as telecommunications, aviation, the services trades and professions, high-tech manufacturing and agriculture would benefit from better access to China.

At present, however, our exports are limited. The \$75.4 billion in bilateral US-China trade last year represents \$62.6 billion in goods imports from China and \$12.8 billion in goods exports from the United States to China. Service export figures are not yet available for 1997, but are quite small; in 1996 we exported \$3.1 billion in services to China while importing \$2.0 billion, resulting in a small surplus. The total trade deficit -- nearly \$50 billion in 1997 and on a trajectory for \$60 billion by the end of 1998 -- has many causes, most important among them shifts of production among the Asian economies and the strength of the U.S. economy. But trade barriers are also a factor.

China restricts imports through means including high tariffs and taxes, non-tariff measures, limitations on which enterprises can import, and other barriers. The result is a pervasive and multilayered web of trade barriers in China. And we use all the tools at our disposal -- our own trade laws, bilateral talks, regional and multilateral negotiations -- to eliminate them.

TRADE BARRIERS IN CHINA

Due to limitations of space and time, I will cite only some of the major types of obstacles we encounter in China. They fall into two main areas.

The first are broad structural impediments. These include transparency, where while we have seen improvements, publication of laws and regulations is still incomplete, and sometimes offset by opaque customs procedures, administrative guidance and other procedures. Another is trading rights, where China restricts the right of individuals and companies to import and export. State-owned enterprises produce about 40% of China's industrial output, raising the question of

subsidies and conflicts of interest for government bodies which both own and regulate enterprises. And government procurement presents a large set of issues, beginning with the fact that China has no laws or regulations on the subject.

The second area is that of more formal and familiar trade barriers. Tariffs, though reduced from an average of 42.1% in 1992 to 17% today, remain high. Non-tariff measures include non-transparent and WTO-inconsistent import licensing, quotas and other barriers. China's market for services remains largely closed. Agricultural tariffs remain very high, and in cases like meat can be prohibitive. China's phytosanitary and veterinary import quarantine standards (for example, regulations affecting citrus products and Pacific Northwest wheat) are often not based on science, unevenly applied and not backed up by modern laboratory testing techniques.

Our aim is, over time, to eliminate these barriers. In some cases we have found bilateral talks, including threatening or imposing sanctions when necessary, an effective way to address them. Let me discuss two particular instances: intellectual property rights and textiles.

U.S. TRADE POLICY: THE CASE OF INTELLECTUAL PROPERTY RIGHTS

In the past, pirated works have been common in China. Since our IPR Agreement in 1996, however, the scale of piracy has been significantly reduced. In 1995, American copyright firms reported losses of over \$2 billion from piracy of software, CDS and CD-ROMs, books, audio and videocassettes in China. They faced further losses in third markets caused by exports from Chinese pirates. Long and intense negotiations won agreements in 1995 and 1996 committing China to pass and enforce copyright and patent laws and shut down pirate operations. Since then:

- China has closed over 64 CD and CD-ROM production lines and the Chinese have destroyed the masters and molds being used to produce these products.
- China has arrested more than 800 people for IPR piracy.
- China has seized more than fifteen million pirated CDS and CD-ROMs, including those illegally smuggled into China.
- China issued 114,000 patents and 121,000 trademarks in 1997, many of which went to U.S. companies.
- Last month, the government of Guangdong Province announced that it had seized and destroyed 2.8 million pirate video compact discs. Guangzhou has been one of the key transit points for VCDs smuggled into mainland China from Hong Kong and Macao.

The work is not at an end. Pirated retail CDS, CD-ROMs, and VCDs remain available in some Chinese cities. Chinese Customs and local anti-piracy officials must be more vigilant in

enforcement. Unauthorized use of software in Chinese government ministries is a problem, and we are urging the Government of China to issue a State Council Directive prohibiting “end-user” piracy. Protection of well-known trademarks is inadequate in China, and trademark counterfeiting remains widespread. And while the 1992 bilateral agreement permits U.S. pharmaceutical companies to obtain up to seven years of “marketing exclusivity” for products still under patent in the United States, China’s Ministry of Public Health may be cutting back the benefits of this agreement by granting overly broad marketing approvals to competing Chinese pharmaceutical companies as U.S. applications for marketing exclusivity are pending.

We also have concerns about protection of intellectual property rights in Hong Kong and Macau. This year we noted an increase in piracy in Hong Kong, and placed Macau on the Priority Watch List of our annual Special 301 report. An IPR team from our office is working with Hong Kong and Macau, and both governments are taking steps to address our concerns.

U.S. TRADE POLICY: THE CASE OF TEXTILES

The second example is textiles.

In 1994, and in February of 1997, the Administration reached bilateral agreements with China to achieve fair trade in textile products. In 1997, for the first time, our bilateral agreement provides for market access for U.S. textiles and apparel into China’s market. China has also agreed to ensure that non-tariff barriers do not impede the achievement of real and effective access for US textile and apparel exports into China’s market. Following on cutbacks in China’s textile quota growth rates under the 1994 agreement, the 1997 agreement further reduced the overall quota to address enforcement issues. China, having once been our largest source of textiles and apparel, is now our fourth.

Illegal transshipments of textiles from China has been a significant concern. We remain resolved to act against such imports. In 1994 and 1995, the Administration found and charged transshipped products against China’s quotas. In 1996 we triple-charged China’s quotas, and we did so again this year to account for such illegal transshipment. We will continue to be vigilant to prevent transshipment.

BILATERAL PROBLEMS REMAIN

In both of these cases, we have advanced concrete American commercial interests and our broader interests in the rule of law and acceptance of international standards in China. However, significant bilateral trade problems remain.

Several of these are in agriculture. China has not resolved sanitary and phytosanitary issues with respect to citrus, Pacific Northwest wheat and meat. And at times China has taken unpredictable measures which reverse our progress. Last October, for example, China raised the tariff on soybean oil to 20%, just as U.S. soybean oil products were entering world markets.

Through quick action we were able to reverse this.

Services are another problem area. Last spring, for example, China issued a decree requiring foreign financial information services to pay royalties to the Chinese government news agency. Again, we have prevented the implementation of this requirement.

And just last April, China announced an arbitrary ban on direct sales, intended to block scam schemes but also affecting well-regarded, law-abiding foreign operations. We are working with U.S. industry and Chinese authorities to address this issue.

COMMERCIAL PRINCIPLES OF WTO ACCESSION

On a broader scale, China's accession to the World Trade Organization, on a commercially meaningful basis, presents us with a comprehensive means to address the broad range of official and unofficial barriers to the Chinese market.

China's application to join the WTO is, of course, an historic event in itself. For decades, China -- together with Russia -- was one of the great antagonists of the principles the WTO embodies: open and transparent markets, the rule of law, and peaceful settlement of disputes. Thus the United States welcomes and supports China's application to join the WTO. However, we and other WTO members believe accession must be on commercially meaningful grounds.

The WTO is a contractual set of commitments, deepened continuously since the establishment of the GATT after the Second World War. These have developed from tariffs -- and our negotiations with China address tariff rates on more than 6,000 individual tariff lines -- to rules on nondiscrimination, national treatment, transparency, judicial review, uniform application of laws, customs procedures and other topics. And the sectors covered by the WTO have expanded from industrial goods to agriculture and services including basic telecommunications and financial services. All applicants, including China, must make commercially meaningful commitments in these areas.

STATUS OF WTO NEGOTIATIONS

This week I returned from China where I had a number of meetings with Ministers and other Chinese leaders on China's accession to the WTO. As many of you will have observed, the negotiations on WTO accession have proceeded slowly and sometimes unevenly. But the trajectory of those negotiations have been positive, especially when viewed over the last eighteen months.

During that period, China has made commitments on a number of critical issues related to rules of the WTO. For example, China committed to WTO obligations related to transparency, judicial review of administrative decisions, and nondiscrimination. China also agreed to phase in trading rights over three years, and to implement its obligations on Trade Related Intellectual

Property Rights (TRIPs) upon accession.

During the last few weeks, negotiations progressed further. We made some headway on the critically important issues of distribution, but the coverage still remains too narrow. China, for the first time, presented an offer on basic telecommunications services and for the first time put forward an offer on financial services that included securities. However, the gaps are significant. In addition, little progress has been made on agriculture which is one of our key export sectors.

Much work remains ahead on all these issues. We also have more to do on the protocol and working party report which address many of the rules-related obligations. And we will take as long as necessary to get this right, beginning when negotiators meet again this month to continue the talks held in China prior to the President's visit.

In conclusion, let me emphasize three points.

First, we are asking nothing of China that China cannot do or that other countries throughout the world have not done.

Second, there are no shortcuts. Neither we nor any other WTO member can afford a political accession for China or any other country. We will continue to push ahead in these negotiations because it is in China's interest, in the United States' interest, and in the world's interest to see China in the WTO on commercially meaningful terms.

And third, China would do well to speed up its decisions on the WTO, because as time passes a commercially meaningful offer will require more than it does today. China first indicated an interest in GATT membership in 1986. By 1994, as negotiations continued, we had completed the Uruguay Round, deepening coverage of agriculture, subsidies, government procurement, investment intellectual property; binding tariffs; and requiring binding dispute settlements. By the beginning of this year, the WTO had advanced through the Information Technology Agreement, the Agreement on Basic Telecommunications and the Financial Services Agreement. Next year we will open negotiations through the WTO's "built-in agenda" on agriculture, services, intellectual property and other issues as well. In the future lie yet further talks. Thus, the longer China delays making a commercially meaningful offer, the more comprehensive a commercially meaningful offer must become.

CONCLUSION: NORMAL TRADE RELATIONS AND BROADER VALUES

One final point. Trade policy, in its narrowest sense, is about market access and fairness. Our negotiations and our discrete policy objectives focus on the details: tariff lines, copyright enforcement, phytosanitary inspections and so on. And our basic goal is opportunity and fair treatment for American companies, workers, consumers, farmers and ranchers. That is what we seek to achieve in our trade negotiations, and it is why we support renewal of normal trade relations.

But the effects of both trade policy generally and normal trade relations in particular extend beyond commerce to fundamental national interests, values and ideals. We already see that in the contribution of our trade relationship to personal opportunity for Chinese citizens; the development of intellectual property rights and the rule of law more broadly; China's growing stake in a stable, peaceful, prosperous Pacific; and China's willingness most recently to broadcast nationwide the President's news conference in Beijing and his address at Beijing University.

And that brings me back to the broader point of engagement with China. Our discussions of China policy, including trade, concentrate on the problems. Rightly so. But on occasions like this hearing, we should also remember to step back and take the long view.

Just twenty years ago, when we made the initial decision to open normal trade relations, we did very little business in China. Very few Americans visited the country. Very few Chinese read foreign books, saw foreign news or traveled abroad. Few foreign firms -- indeed, few private businesses -- operated in China. China remained among the world's most closed societies, and the prospect of a public discussion of human rights between our Presidents would have been absolutely unthinkable.

Today, with all the problems that remain, we see American business operating in China. The share of the state in the economy has fallen. The range of political debate has widened. And Chinese citizens have seen the President of the United States on live television, speaking of human rights and democracy.

These trends are not only good for China; they are good for America. And they show that the engagement policy, with normal trade relations at its foundation, is working. So again, the Administration strongly supports normal trade relations with China, and looks forward to working with the Committee to ensure its renewal this year.

Thank you, Mr. Chairman. I look forward to your questions and those of the Committee.